not harmed by retiering.[43] The regulatory model CFA recommended in its initial comments describes an effective mechanism for preventing consumer harm that could otherwise result from retiering.[44]

E. THE CABLE INDUSTRY PROPOSAL IGNORES THE EXPLICIT CONGRESSIONAL PROHIBITION ON MARGINAL COST PRICING FOR NON-BASIC SERVICES

The cable industry apparently hopes the Commission will disregard the 1992 Cable Act's explicit prohibition on marginal cost pricing.[45] None of the major cable industry filings even mention this statutory requirement and, as a result, their regulatory proposals fail to account for one of the most important consumer protection provisions Congress included in the Act.[46] By failing to abide by Congress' requirement to spread

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[43] The cable industry suggests that the Commission read the 1992 Cable Act in conjunction with the 1984 Act (47 U.S.C. at §545(a) and (d)), to allow retiering without franchise authority approval (see e.g., Comments of NCTA at 36, Cablevision Systems at 20). However, CFA does not believe that a literal reading of the 1984 Act, as amended by the 1992 Act, can support cable's interpretation of the law.

[44] See Comments of CFA at 84-99.

[45] See Comments of CFA at 6-8, 76-83.

[46] The only awareness of this statutory requirement we could find in the cable industry's filings is in Time Warner's Comments, Dan Kelley's Attachment at FN 36; however, Kelley then disregards this pricing rule.

costs among all services, the cable industry urges a line of regulatory reasoning on the Commission that blatantly violates the 1992 Cable Act.

F. DELAYING IMPLEMENTATION OF RATE REGULATION SIMPLY DENIES CONSUMERS THE PROTECTIONS CONGRESS INTENDED

The cable industry urges the Commission to phase-in or delay implementation of its regulatory rules for 6 to 18 months after the rules are made public.[47] These proposals are preposterous and contrary to Congress' intent in passing the Act. Once the Commission determines that regulation is necessary to protect subscribers from cable's exercise of undue market power, the Commission must reduce rates to a reasonable (not unreasonable) level as expeditiously as possible to achieve Congress' goals.

The Commission should anticipate that the cable industry will take advantage of any laxity or undue flexibility in implementing new pricing rules, based on the industry's current behavior. Since Congress passed the 1992 Cable Act, operators all over the country have continued raising their rates to squeeze subscribers for extra revenue before this regulatory

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[47] See e.g., Comments of TCI at 69, Time Warner at 111, Cox Cable at 6, Cablevision Industries at 10, Cablevision Systems at 15.

proceeding is completed.[48] The Commission must not allow this abuse of procedural due process to continue any longer than is absolutely necessary.

Immediate implementation of the Commission's rules will only begin a slow process of adjustments in the cable industry. It will take franchising authorities time to prepare for regulatory certification and will take subscribers a significant amount of time to evaluate whether to file a complaint concerning cable programming service. Then the Commission must develop an orderly process to handle certification, complaints, etc. and disputes about all these matters. This set of activities involves an inherent phase-in process, giving the cable industry plenty of time to adjust its pricing.

III. THE DETAILS OF THE CABLE INDUSTRY'S BENCHMARK APPROACH ARE INCONSISTENT WITH THE ACT'S GOALS

To the extent the cable industry proposes a detailed regulatory model for the Commission to apply,[49] it violates the fundamental purposes and directives of the 1992 Cable Act.

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[48] Farhi, "Rates for Cable TV Rise In Advance of Limit Law", Washington Post, Dec. 7, 1992 at A18.

[49] Although most cable filings did not explicitly endorse NCTA's benchmark model, their argumentation is generally consistent with NCTA's views on benchmarking.

starting with today's average basic rates -- the very rates Congress concluded were excessive -- adjusted only slightly (with a skewed "competitive system" adjustor), the NCTA's "benchmark" adds numerous inappropriate rate inflators that would ratify monopolistic pricing.

The cable industry then suggests that rates for all other tiers of service should not even be subject to regulatory analysis except in the 2-5% most expensive systems. After an initial regulatory "slap on the wrist" to the few "outlier" systems (if they cannot justify their rates with whatever data they desire to unload on the Commission), the industry proposes an adjustment for cable programming service rates that allows them to rise significantly, in tandem, without any regulatory scrunity.

A. THE INDUSTRY BENCHMARK FOR THE BASIC TIER IS ARBITRARILY BIASED AGAINST SUBSCRIBERS

After rejecting cost of service regulation,[50] NCTA proposes a vastly inflated benchmark for basic tier regulation. NCTA pays

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[50] Comments of NCTA at 10-11, echoed by all other cable industry filings. As we indicated in our initial comments, we strenuously disagree with this critique of cost regulation and Congress' direction to the Commission concerning how to regulate cable. The House Committee Report's discussion of Title II regulation was supported by neither the Senate Committee Report nor the Conference Report. See Comments of CFA at Footnote 8.

lip service to the statute's competitive market pricing limit, but urges the Commission to disregard or discount factors that would tend to hold the benchmark down (i.e., rates in overbuild communities, municipally owned systems) and instead rely on factors that inflate or add to the benchmark (i.e., systems with less than 30% penetration, adding programming costs, franchise fees and taxes, etc.).

NCTA's consultants are biased in their choice of a competitive standard. They claim that head-to-head systems in competition may have prices that are too low, due to "disequilibrium" or "greenmail."[51] They ignore the fact that systems with penetration rates below 30 percent are likely to be high cost systems due to their low penetration rate (but Time Warner's consultant admits this problem).[52] NCTA's consultants

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[51] Of course what the cable industry refers to as "greenmail" may in most instances actually be true hard-nosed competition. It is hard to imagine, for example, that head-to-head competition in Allentown, PA since 1963, Paramus, NJ since 1976 and Sandy, UT since 1980 involve greenmail. Contrary to Continental Cablevision's claim, (Comments of Continental Cablevision at 22) the numerous competitive systems that have arisen in the last five years and have not been swallowed by cable incumbents may provide the most valuable data to achieve Congress' goal: limiting basic rates to competitive market levels.

[52] As he notes (Comments of Time Warner, Kelley Attachment at 25):

> Similarly, the less than 30 percent penetration standard may lead to benchmark rates that are too high if costs are high due to low penetration.

drop municipally owned systems from their comparison altogether, without any explanation.[53]

Congress' effective competition standard may have made more sense as a threshold question of who should be regulated, rather than as an ongoing rate standard. Since there are such dramatic differences between systems in each of the categories of Congress' definition of effective competition, the Commission may be wise not to overly emphasize data from this subset of systems in setting a rate limit. However, if the Commission is going to use Congress' precise definition of competition, it must include all categories of systems described in §623(l)(1). Contrary to cable industry suggestions, the Commission may not choose one category, which is likely to have higher prices for historical and economic reasons, and drop other categories which have lower prices for historical and economic reasons.

The industry proposal is also arbitrary in selecting which factors go into the benchmark analysis. For example, NCTA's consultants state that:

> in general, cable rates were different in high income area than in low income areas. It is doubtful that, as a policy matter, the Commission would wish to use income levels to establish benchmark rates.[54]

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[53] Similarly, Continental Cablevision mentions only the problem of "disequilibrium" in head-to-head competition and ignores the other two effective competition tests.

[54] Comments of NCTA, Owen Attachment at 14.

Yet, any good monopolist will try to segment its market in order to charge whatever the market will bear in each segment. Income certainly is an indicator of ability to pay.

NCTA's consultants make the same mistake regarding the importance of system age:

> The analysis might show that older systems charge higher prices, other things equal. But to base benchmark rates on this distinction is to introduce perverse incentives into the regulatory scheme. The Commission presumably would not wish to penalize cable systems that upgrade their headends.[55]

If the age of the system is a determinant of cost and newer systems have lower costs, then not basing benchmarks on this characteristic will allow systems which upgrade to earn unreasonable profits.

B. THE INDUSTRY BENCHMARKING APPROACH DOUBLE DIPS FOR INFLATION

NCTA and its consultants propose a quasi cost analysis based on system characteristics, but they throw in inflation adjustments. In effect, they double account for inflation.

Cost equations should not be "adjusted for inflation." If

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[55] Id., at 14.

rates stay the same and cost factors in the benchmark model indicate that the median is the same, then economies have been achieved and there should be no indexing. In essence NCTA's consultants advocate a double dip:

> To keep up with changing conditions, the B1 benchmark rates should be adjusted annually based on changes in the median rate of the benchmark competitive system. This will in principle take account of <u>increased costs of service due to inflation</u>, decreased costs of service due to technological innovation, and the addition of new programming services. The procedure would require calculating the median value of B1 for those competitive systems used in calculating the competitive adjustment holding constant the factors that are incorporated in the B1 benchmark rate tables. The median value would be calculated at the time the regulations are established and annually thereafter, using the same methodology. The percentage change in the median value would then be applied to the initial benchmark rates. When testing the rates of any cable system against the applicable benchmark, <u>an adjustment will be required to account for inflation</u> between the time of the benchmark survey and the time of the test.[56]

When regulatory bodies take benchmark rates, which are presumed to be reasonable, and then inflate them, they are doing so to approximate cost changes, because they are not engaging in cost analysis. What NCTA has proposed is a quasi-cost analysis. If costs do not keep up with inflation, that will be reflected in the statistical analysis and they should not be recovered. If they exceed inflation, that too will be reflected in the statistical analysis and they will be recovered. Under no

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[56] Owen op. cit. at 24, [emphasis added].

circumstances can the Commission do a quasi-cost analysis and allow an inflation adjustment.

Moreover, as the Commission recognized in the telecommunications area, and as CFA documented in the case of cable, with technologically dynamic and expanding industries, one can expect costs to be falling.[57] Inflators would never simply be added onto rates without adjusting for productivity increases. To do so would deny consumers the benefits they normally enjoy in competitive market situations. This violates the explicit intent of the Cable Act.

C. THE INDUSTRY'S BENCHMARK BASKETS AND PASS THROUGH ARE ILLEGAL BECAUSE THEY VIOLATE THE EXPLICIT CONGRESSIONAL INTENT TO PRECLUDE MARGINAL COST PRICING OF NON-BASIC SERVICE AND TO ENSURE A FAIR CONTRIBUTION TO FIXED COSTS FROM ALL SERVICES

The industry comments repeatedly propose, explicitly and implicitly, marginal cost pricing of non-basic service, an approach that was explicitly rejected in the Conference Report.

NCTA asserts that there is "no regulation of per-channel and

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[57] _See_ Comments of CFA at 17-28, 40-70. Astoundingly, Continental Cablevision asserts that "the cable industry is an _increasing_ cost industry," without any factual basis in its comments or attachments to support this ridiculous claim (_see_ Comments of Continental Cablevision at 25).

per-program services,"[58] yet fails to admit that the Conference Committee explicitly instructed the Commission to constrain rates for all services by allocating joint and common costs to per-channel/program offerings. This was effectuated as a direct modification of the House bill's language:

> The language concerning joint and common costs is clarified to ensure that joint and common costs are recovered in the rates of all cable services, not only in the rates for basic cable service, as determined by the Commission... The conferees believe that the basic cable tier should not be required to bear a larger portion of the joint and common costs than would be allocated on a per channel basis. The regulated basic tier must not be permitted to serve as the base that allows for marginal pricing of unregulated services.[59]

Contrary to the explicit requirements of the Act, NCTA and its consultants present a bundling approach that explicitly adopts marginal cost pricing for many services: "entirely new tiers made up of entirely new program service would fall under the pass through provision . . . "[60] By keeping new services out of the regulated bundles, NCTA precludes contribution to joint and common costs.

Even for system growth, NCTA's consultants have concocted a

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[58] Comments of NCTA at 3.

[59] Conference Report at 63.

[60] Owen, op. cit., at 28.

scheme that denies subscribers any rate benefits which would result from the allocation of joint and common costs across the additional services sold. The consultants advocate manipulating the weighing of bundle elements to prevent rate decreases. They utilize pre-expansion weights in order to prevent these services from making any contribution to joint and common costs.

In the following quote, the consultants describe the example of increased sales of remote controls and outlets, but the same principle applies to programming, as the consultants admit:[61]

> Suppose a system with its rates and quantities sold as of April 1, 1993 is just below the Commission's B2 benchmark rate applicable to that system. Over the next several months, as a result of successful marketing efforts and without changing its rates, the system increases the number of subscribers taking remote controls or additional outlets. This by itself might have the effect of increasing the average revenue per subscriber and might put the system above the B2 benchmark rate.
>
> The way to deal with the problem of increased demand in the presence of constant rates is to use as weights (in computing the weighted average of rates that comprises B2) the quantities sold as of the benchmark date, rather than the test date.[62]

If the rates were just below the benchmark, then profits were just below the threshold of becoming unreasonable. Now the

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[61] Owen, op. cit., at FN 29.

[62] Id., at 26-27.

system expands. Fixed costs are spread over more units sold. Profits have now increased. In a competitive market, of course, this would attract the attention of competitors, who would seek entry and drive prices and profits back down to reasonable levels.

By violating the benchmark, profits are now unreasonable. If test year weights are used, rates must be lowered to eliminate the excess. The rate of profit is returned to a reasonable level (of course, the company may earn a larger total profit).

Indeed, the weighing scheme concocted by NCTA's consultants is explicitly intended to protect cable operator income, regardless of its effect on subscribers:

> Hence, the new rates would be not unreasonable if they produced an average revenue below the benchmark rate or below the system's average revenue just prior to the rate increase, using weights from just prior to the increase, regardless of their ultimate effect on actual average subscriber revenues.[63]

Time Warner and it's consultant repeat this misreading of the law. Although the consultant acknowledges that Congress explicitly rejected marginal cost pricing of non-basic cable service, he proceeds to disregard Congress' explicit pricing

[63] Owen, op. cit., at 28.

directive.[64] The fact that basic service requires the customer drop and a customer account is used to suggest that basic service subscribers, alone, should pay those costs. The fact that the other channels -- perhaps as many as 147 to 490 -- also use the drop and the customer account, is ignored, contrary to the Act:

> The Cable Act specifically mentions that cable programming prices should not be based on an incremental assignment of cable system costs. However, many of the fixed system costs described above are indeed assignable, in an economic sense, to the basic tier and are appropriately recovered from basic subscribers. For example, if customers are only required to purchase basic service, then the costs of establishing and maintaining a customer account, the cost of the drop, and the cost of bundling and operating a system with the capacity to provide basic service are directly assignable to basic service customers.[65]

It is precisely this sort of abusive pricing that Congress intended to prevent, not only in banning marginal cost pricing, but also in establishing a per channel allocator as the upper limit on the allocation of fixed costs for the basic service tier.

Ironically, Time Warner's consultant invokes this illegal pricing theory at the same time that he admits one of the key characteristics of the industry: declining cost per channel as

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[64] Comments of Time Warner, Kelley Attachment at 28-29.

[65] Id., at FN 36.

the number of channels increases.[66]

Continental Cablevision reiterates Time Warner's illegal position in its comments:

> Customer costs, such as maintaining an account, billing, processing and other costs that vary strictly with the number of customers on a monthly basis might be allocated as joint and common costs or, alternatively, they might be attributed to a separate functional category...
>
> If the cost allocation relied upon channel allocations of joint and common costs, increases in a system's channel capacity using digital compression could artificially suppress legitimate basic service cost allocations. This result will certainly not produce a fair and reasonable rate for the basic service tier, particularly because the added channel capacity created by compression will be used primarily for a la carte channels priced on a per-channel basis, and likely appealing to increasingly specialized, smaller number of viewers. These anomalies can be avoided in several ways. Channel-based cost allocations could, for example, exclude channels devoted to programming priced on a per-channel or per-event basis. Alternatively, the capacity of various systems could be set at fixed reference indicators, similar to how the Commission treats digitally multiplexed telephone lines for rate regulation.[67]

Both of the "fixes" that Continental suggests must be rejected by the Commission. The Conference Report makes it clear beyond a shadow of a doubt that the Commission cannot exclude per channel

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[66] Kelley, op. cit., at 28.

[67] Comments of Continental Cablevision Appendix B at 18-20.

or per program services from the allocation of joint and common costs.

D. THE INDUSTRY PROPOSAL VIOLATES THE LAW WITH RESPECT TO RETIERING OF SERVICES

The NCTA's regulatory scheme explicitly allows retiering to impose price increases on consumers, without any change in quality. It argues that it's benchmark approach to rate changes, which ignores the ultimate effect on subscribers, can be applied to retiering:

> In computing B2 after a realignment of program services by a cable system, the Commission should use the weights that were applied to individual services prior to the change... Once this new B2 is calculated, it would be compared to the benchmark rate and the system's old B2 as was done when evaluating a rate change.[68]

This approach ratifies the cable industry's practices of bundling to extract consumer surplus. The industry will move its most popular programming from lower priced (regulated) tiers to high priced (less regulated) tiers. A certain number of subscribers will follow, forced to take the higher priced tier in order to keep the popular programming. This results in a net increase in revenues and rates. Because the industry's formula

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[68] Owen, op. cit., at 28.

uses the old weights, NCTA claims there is no evasion of the Act -- no retiering harm. However, this is a clear violation of Congress' intent:

> The conferees are concerned that such retiering may result in the evasion of the Commission's regulations to enforce the bill. The conferees expect the Commission to adopt procedures to protect consumers from being harmed by any such evasion.[69]

E. THE INDUSTRY'S REGULATORY SCHEME IS SO LAX THAT IT VIOLATES THE CLEAR CONGRESSIONAL INTENT TO PROTECT CONSUMERS AND PROVIDE RELIEF FROM EXCESSIVE RATES

Basically, the cable industry proposes to allow cable operators to do just about anything under its benchmark approach to avoid rate reductions and defend rate increases. NCTA urges the Commission to:

> establish benchmark rates that are likely, in almost all cases, to cover the costs -- plus a reasonable profit -- on any service that the operator might choose to process, and any facilities that might be used to provide such services.[70]

That NCTA intends for there never to be any restraint on rates is clear when a showing has been made that rates are

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[69] Conference Report at 65.

[70] Comments of NCTA at 11.

unreasonable. Even here, it suggests that "in lieu of requiring prospective rate reductions, an operator should be permitted to reconfigure its tiers to reach the benchmark."[71]

The rate indexing mechanisms proposed by the cable industry are nothing more than upward ratchets. After allowing virtually every rate to be found reasonable (95 to 98 percent), NCTA then proposes to allow virtually every rate <u>increase</u> to be found reasonable (95 to 98 percent):

> To avoid this problem, a better approach would be to determine, after the <u>first</u> calculation of benchmark rates, the percentage difference between the <u>median</u> rate and the rate for the 95th percentile. This difference would represent, for future calculations, the difference between the median rate and "unreasonable" rates. In subsequent years, the Commission would recalculate the median rate and increase it by the established percentage to determine the new benchmark for unreasonable rates.[72]

As the median rises, the absolute value of the gap rises in a never ending spiral.

TCI goes so far as to argue that even after this ratchet has

[71] Comments of NCTA at 77.

[72] Id., at 63.

been allowed, there should be an "open season" to raise rates even higher:

> One possible solution is an "open season" refinement every several years to ensure that industry-wide improvements can be made without undue regulatory disruption.[73]

Recognizing that these upward ratchets exist, the industry filings repeatedly claim that operators will engage in self-control:

> There might be theoretical concerns about cable companies gaming the adjustment process by raising rates simply to get the average up. However, if on average the current rates are both reasonable from an efficiency standpoint and profit maximizing, the benefits to the cable operators of attempting to raise the benchmark in this way are questionable. Higher prices would lead to overall lower profits or the prices would have been set higher in first instance.[74]

What this says is that if there was no market power, or if cable companies exploited their market power perfectly, they will not have an incentive to game the price escalator. However, anywhere in between these extremes, this proposed "toothless" regulatory approach will give cable operators an opportunity to further abuse ratepayers.

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[73] Comments of TCI at 30.

[74]

In designing this regulatory scheme, the cable industry replaces regulatory oversight with self-restraint:

> The concern expressed in the NPRM that this approach might inadequately protect consumers from "potentially unreasonable rate increases" is ill-founded. Cable operators are unlikely to implement any rate change they fear has a strong likelihood of requiring subsequent refunds.[75]
>
> Cable operators have little incentive to price unreasonably once reasonableness has been established as a matter of federal law.[76]

Congress concluded that neither market forces, nor self-control had restrained abuse of subscribers where there was no effective competition. Congress intended for the Commission to impose restraint on rates. To allow rate escalators that fall back on self-restraint violates the clear purpose of the Act.

F. THE INDUSTRY'S REGULATORY SCHEME IS SO UNBALANCED THAT IT VIOLATES NOT ONLY THE CABLE ACT'S INTENTION TO PROTECT CONSUMERS, BUT ALSO THE MOST FUNDAMENTAL CANNONS OF REGULATORY LAW

According to the industry, cable operators should always be given the right to challenge rates they believe are too low, but intervenors should never be given the right to challenge rates

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[75] Comments of Continental at 46.

[76] Comments of TCI at 52.

that are too high.[77] The invitation for cable operators to contest any finding that their rates violate the benchmark (a near impossibility in any event) is remarkably broad.[78]

NCTA rests its claim for one-way benchmark challenges on the notion that potential harm to operators is a greater crime than harm to subscribers:

> But benchmarks, by their very nature, cannot ensure that basic rates are perfectly competitive in each individual case. In some cases, to be sure, the benchmarks may allow rates that exceed an operator's costs plus a reasonable profit, while in other cases, the benchmark may be too low to allow recovery of such costs. The problem is that while errors of the first type could raise rates for cable service to artificially high levels, errors of the second type could prevent cable operators from offering service altogether. Requiring rates to be set at non-remunerative levels would diminish or eliminate the availability of cable service in a community -- and it would, in any event, be in conflict with the Fifth and Fourteenth Amendments to the Constitution, which prohibit rate regulation that prevents rates at confiscatory levels.
>
> To avoid undesirable and unconstitutionally confiscatory errors of this type, a benchmark approach to basic regulation requires at least four types of safeguards.[79]

This reasoning must be flatly rejected by the Commission.

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[77] Comments of NCTA at 39.

[78] Id., at 40-41.

[79] Id., at 34.

The cable industry's exaggerated constitutional claims provide no basis for skewing Congress' directives or distorting the Commission's historically balanced regulatory procedures. The Cable Act as well as sound regulatory practice require fair, symmetrical treatment of both subscribers and cable operators.

Typically, one of the most important elements of a fair regulatory scheme is a balance between the interests of stockholders and ratepayers. Yet the cable industry recommends an unbalanced scheme claiming that constitutional rights may be at stake which carry more weight than the rights of citizens to be protected from the abuse of market power. In other words, the industry is trying to scare the Commission into establishing a meaningless benchmark with a one-way appeal process, by threatening to sue the Commission. Of course the Commission is just as likely to face legal challenge for disobeying Congress, if it follows the cable industry's suggested sham regulatory model:

> We emphasize that we do not hold that a taking occurs every time a prudent investment is made but not included in the rate base . . . . Under Hope, as we have stated repeatedly, the only circumstance under which there is a possibility of a taking of investor's property by virtue of rate regulation is when a utility is in the sort of financial difficulty described in Justice Douglas' opinion. If a utility is in that state, the Commission must inquire whether a reasonable return -- on investment, not on facilities -- has been afforded to investors, taking into account whether any higher return would amount to exploitation of consumers. Under those circumstances, it may be permissible or even proper to grant the utility a

greater return on its prudent investments than it otherwise would have received. But absent the sort of deep financial hardship described in Hope, there is no taking, and hence no obligation to compensate, just because a prudent investment has failed and produced no return. And even where the sort of deep financial hardship described in Hope is present, the utility is entitled only to an "end result" hearing, and is not entitled to any greater return on its investments unless it shows at the hearing both that the rate was unreasonable and that a high return would not exploit consumers.[80] (Starr, Circuit Judge, concurring): (a regulatory order requiring ratepayers to pay monopolistic prices would fail to achieve the constitutional balance of interests. That sort of order would work a taking of ratepayers' property . . .).[81]

Whether an unbalanced regulatory scheme is more or less likely to be overturned in the courts as a violation of the Act, than a balanced system of regulation is likely to be considered constitutionally suspect, is totally uncertain. Most importantly, the cable industry's scare tactics[82] should not be allowed to influence the Commission's crafting of the rules mandated by Congress under the Cable Act.

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[80] Jersey Central Power & Light Co. v. FERC 810 F.2d 1168 (1987) at 1181 n.8. [emphasis added].

[81] Id., (Starr concurring).

[82] The Commission should dismiss the industry's similar scare tactics regarding the potential "deluge" of complaint filings under the Act (see Comments of NCTA at 61-62). Once the Commission establishes a simple benchmark applicable to individual cable communities, it does not matter how many complaints are filed; one complaint is as good as a thousand complaints concerning: 1.) existing rates, for the first 180-day period and 2.) future rate increases above an adjusted benchmark.

G. THE INDUSTRY'S REGULATORY SCHEME IS SO UNRULY, IT IS HIGHLY UNLIKELY TO LEAD TO ADMINISTRATIVELY DEFENSIBLE RESULTS

Not only must the appeals process of a benchmark be balanced, it must be organized in a manner that leads to comprehensible results. The cable industry insists that accounting is fragmented and costs are diverse throughout the industry. And, while the cable companies are loathe to shoulder any administrative burden created by the Commission, or any discipline in the presentation of costs, they are perfectly willing to place extensive burdens on regulators to deal with whatever cable companies would like to file:

> The Commission can, however, adopt rules that reduce the likelihood that its benchmark approach will ultimately require resorting to litigation as to whether allowable rates are unconstitutionally confiscatory. To rule that cable operators must be entitled to rebut the applicable benchmark is not necessarily to require full-fledged cost-of service ratemaking. In the first instance, cable operators <u>simply should be permitted to make whatever showing they choose in order to demonstrate to the franchising authority that its costs justify rates higher than the benchmark allows</u>. Franchising authorities should, at the least, be required to respond in writing to any such showing, and any written denial of an operator's request for a higher rate should at least be reviewable by the Commission under an "arbitrary and capricious" test.[83]

There is no better example of this complete lack of

[83] Comments of NCTA at 41-42 [emphasis added].

discipline than in the empirical analysis of Continental Cablevision's consultants. While presenting data in tables that deal with certain characteristics of several publicly held cable companies, they vaguely discuss characteristics of Continental. However, the first reference is to Continental's "largest regional operator,"[84] the second is to "some of Continental's multi-system regions,"[85] and the third is to Continental's "aggregate reinvestment."[86] As a result, it is literally impossible to tell whether any of the specific conclusions of the consultants apply to any of the specific entities that will be directly regulated by the Commission. If this sort of selective data presentation is not rejected, the Commission's regulatory process will be undermined.

If the industry is unwilling to accept accounting standards, it is simply impossible to see how local authorities or the Commission will be able to tell when "an operator's costs clearly and demonstrably exceed what the benchmark would allow." The Commission must reject this unruly process by developing a standardized approach to cost accounting as recommended in Appendix A of the Commission's Notice.

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84 Comments of Continental, Appendix C at 11.

85 Id., at 12.

86 Id., at 13.

H. THE INDUSTRY'S BENCHMARKING PROPOSAL IS COMPLEX AND UNWORKABLE

The NCTA's consultants propose an extremely complex statistical approach that will yield confusion without producing a sound basis for ratemaking. This is especially the case because they rely on low penetration-rate systems.

The proposal requires gathering extensive data on system characteristics and rates and the application of statistical procedures which are highly susceptible to erroneous results. Because there is likely to be virtually no overlap in penetration rates between competitive and non-competitive systems, the factors identified in the first step may not be reflective of the cost factors in the combined sample. Moreover, the dramatic difference between costs in low penetration systems, which are likely to have a smaller number of channels, make it extremely difficult to model these differences or to trust the "competition" dummy variable.

The scheme concocted by the cable industry involves an extensive regulatory data oversight burden, created at the whim of a cable operator. Their regulatory model proposes that the Commission leave it to the industry's discretion whether or not to use cost data, and then only to use such data to raise rates. For example, the quasi-cost function analysis proposed by NCTA